

**WAMI**



**IMAO**

THE ZONAL WORKSHOP FOR THE MASS MEDIA IN  
THE WEST AFRICAN MONETARY ZONE  
CONAKRY, REPUBLIC OF GUINEA, JUNE 8, 2004

**WAMI/ZW/4**

# **THE CHALLENGES OF INTRODUCING THE Eco CURRENCY**

BY  
Dr. M. O. OJO  
Director General  
West African Monetary Institute  
ACCRA, GHANA

## TABLE OF CONTENTS

	Page
1. INTRODUCTION.....	1
2. PERFORMANCE ON THE WAMZ PROGRAMME.....	1
2.1 Macroeconomic Developments and Status of Convergence.....	2
2.2 Design of WAMZ Architecture.....	3
3. OUTSTANDING CHALLENGES.....	4
3.1 Expediting the Convergence Process.....	4
3.2 Implementing the Sensitisation Programme.....	4
3.3 Discharging Financial Obligations.....	5
3.4 Ratification of Legal Instruments.....	5
3.5 Determining Final Eligibility and Sustainability of Monetary Union.	6
4. 4.0 ARRANGEMENTS TOWARDS INTRODUCING THE Eco.....	6
4.1 Exchange Rate Mechanism.....	6
4.2 A Unit of Account.....	7
4.3 External Value of the Eco.....	7
4.4 Phased Introduction of the Eco.....	7
4.5 Payments Systems Development.....	7
4.6 Currency Management.....	8
5.0 SUMMARY AND CONCLUSION.....	8
SELECTED REFERENCES.....	9

# **THE CHALLENGES OF INTRODUCING THE Eco CURRENCY**

## ***INTRODUCTION***

The West African Monetary Zone (WAMZ) programme, designed to usher in a second monetary union of five countries (The Gambia, Ghana, Guinea, Nigeria and Sierra Leone; with Cape Verde and Liberia as observers) in West Africa, has been implemented from 2000 to date. The objective of the WAMZ is to establish a monetary union characterised by a common central bank and a single currency to replace the existing five national currencies. The concept of the second monetary zone was endorsed in December 1999 by the Authority of Heads of State and Government of the Economic Community of West African States (ECOWAS) to facilitate the achievement of the goal of a single monetary zone in the sub-region, following a prolonged delay in its realisation due to economic and political problems. It was envisaged that the successful launching of the second monetary zone would facilitate the merger with the CFA zone to usher in the ECOWAS single currency. The West African Monetary Institute (WAMI) was set up to prepare member countries for the second monetary union, by implementing the WAMZ programme, consisting of a set of macroeconomic convergence criteria that member countries were to attain, and building the architecture of the WAMZ. The successful implementation of the programme would pave way for the launching of the common currency of the zone, the Eco.

The WAMZ monetary union was originally scheduled to take-off in January 2003. However, following the mid-term 2002 convergence assessment, it was concluded that although some achievements were recorded, these were not adequate enough to support the take-off of the monetary union in January 2003. While the achievements in terms of architecture design were significant, the poor performance in macroeconomic and policy convergence would constrain the operations of the envisaged monetary union. Among the major problems, which confronted the programme was the inadequate commitment of the member countries, especially in supporting their expressed commitment with concrete actions. Besides, some member countries continued to experience civil conflicts, which tended to relegate serious economic management to the background. Consequently, the WAMZ programme was extended to June 30, 2005. The common Central Bank is expected to take-off on July 1, 2005. This was to give enough time to member countries to apply appropriate policy measures to achieve convergence and thus provide an enabling environment for the operationalisation of the common Central Bank and the launching of the Eco.

The primary purpose of this paper is to highlight the challenges on the way to the introduction of the Eco. The remaining parts of the paper are a highlight of the performance on the WAMZ programme in part two, the outstanding challenges in part three, arrangements towards introducing the Eco in part four; and summary and some concluding remarks in part five.

## **2.0 PERFORMANCE ON THE WAMZ PROGRAMME**

A good track record of macroeconomic performance and sustenance of compliance with the convergence criteria are a precondition for the launching of the Eco. Without

macroeconomic convergence, the Eco may not be viable. These preparatory activities were to create the environment for the successful launching of the Eco. In addition, without appropriate architecture, the ideal environment for launching the Eco may be non-existent. It is therefore necessary that convergence is attained while the architecture of the WAMZ is designed to facilitate the introduction of the common currency, the Eco. Performance will be reviewed in respect of macroeconomic developments and compliance with convergence criteria, and the design of the architecture of the WAMZ.

## **2.1 Macroeconomic Developments and Status of Convergence**

The macroeconomic performance in the WAMZ countries was generally mixed during 2003. Although there were improvements in some macroeconomic indicators, inflation accelerated rapidly to a double digit in all the countries owing largely to upward adjustments in the prices of petroleum products, high monetary growth rates occasioned by reliance on central bank resources for financing of fiscal deficits, and supply constraints. There were signs of improvement in the fiscal stance, albeit marginally, in most countries as the overall fiscal deficit, excluding grants narrowed. On the whole, however, the countries still remained fiscally fragile. The balance of payments also recorded slight improvements, with narrowing of overall deficits and consequent additions to gross external reserves. Real GDP recorded better growth rates in most countries than in the previous year.

The progress in macroeconomic convergence weakened in 2003. The status of compliance with the primary convergence criteria showed that at the end of 2003, all the countries moved down on the convergence scale, except Ghana that improved on its 2002 performance. Ghana missed all four primary criteria in 2002 but rebounded in 2003 satisfying 2 primary criteria, one of which was a critical criterion, the financing of government deficit by the central bank. Overall, 2 countries, Ghana and Nigeria, satisfied 2 criteria each. The Gambia satisfied 1 criterion that of reserves-import cover. Guinea and Sierra Leone satisfied none of the 4 primary criteria. While Ghana satisfied the critical criterion of central bank financing of fiscal deficit and reserves-import cover, Nigeria narrowly missed the critical criterion of central bank financing of fiscal deficit but satisfied the criteria on reserves-import cover, and fiscal deficit-GDP ratio. Inflation remained a major problem in all the WAMZ countries as the entire member countries missed the target, including Guinea that hitherto had low inflation record. The inflation problem was accounted for by expansionary fiscal operations and hikes in the prices of petroleum products and public utilities in some of the countries. The inflationary impact of monetary financing of the budget showed clearly in the inflation data of The Gambia, Guinea, Nigeria and Sierra Leone. The situation before the extension of the WAMZ was more robust than the outcome in 2003. Instead of making progress, countries deteriorated because of failure to address the fiscal dominance phenomenon. The macroeconomic performance of the WAMZ is negatively influenced by fiscal dominance, which entails monetary financing of the fiscal deficit. It was in the drive to correct this problem that the Forum of Finance Ministers was established. However, the zone is yet to benefit fully from the arrangement because its policy recommendations have not been systematically implemented by the member countries.

In spite of the low outcome on the primary criteria, performance on the secondary convergence criteria showed an encouraging trend. Ghana and Nigeria met the 20.0

percent target on tax revenue as a percentage of GDP in 2003 compared with 2002 when no country met the benchmark. Sierra Leone and The Gambia also made commendable efforts raising the ratio of tax revenue to GDP above their previous year's performance, although the levels achieved were below the WAMZ target. Guinea would need to make more efforts, as its end-year performance was comparatively low. The performance on the wage bill criterion also showed improvement. Two countries, The Gambia and Nigeria, kept wages and salaries below 35 percent of tax revenue compared with only one country at the end of 2002. Guinea, which met the target in 2002, however, slipped slightly on this criterion, with the wage bill at 36.7 percent of tax revenue. Ghana and Sierra Leone made efforts at reducing the wage bill to 49.6 and 59.7 percent of tax revenue at end December 2003, from 57.2 and 63.2 percent in 2002, respectively. Ghana met the criterion on public investments financed from tax revenue, recording 43.4 percent at year-end. The outcome in Guinea and Sierra Leone at 12.1 and 10.6 percent, compared favourably with the previous year's efforts although these were still below the WAMZ target of 20 percent. Nigeria's performance was lower compared with previous years. The Gambia would need to intensify effort on this criterion. Insufficient data on the stock of domestic arrears in the countries made it difficult to assess performance with respect to this criterion. However, there were indications that some countries were pursuing programmes to substantially reduce domestic arrears in the short- to medium-term. Owing to the inflationary pressures in 2003, performance on the interest rate criterion deteriorated with no country recording a positive real average savings rate. The nominal exchange rates on the other hand were relatively stable in four of the countries. Only The Gambia experienced depreciation above 15 percent during the period. Until fiscal dominance is decisively tackled by a zone-wide policy of zero financing of fiscal deficit by the central banks, it may be difficult for The Gambia, Guinea, Nigeria and Sierra Leone make significant progress on the convergence scale. With sustained effort at fiscal consolidation and proactive monetary policy, Ghana is likely to make further progress on the convergence scale. With the poor macroeconomic performance and convergence record, the road to the Eco may be bumpy, but the challenges can be effectively addressed with greater determination.

## **2.2 Design of WAMZ Architecture**

At its inception, WAMI commenced work rapidly on the design of the policy and institutional frameworks of the architecture of the WAMZ. At the point when the decision was taken to extend the launch date for the monetary union, a robust architecture had been built for the WAMZ. The policy frameworks for the WAMZ architecture already concluded are the monetary policy, external reserve management, exchange rate mechanism, system of banking supervision and the central bank system. The institutional frameworks include the central bank organizational structure, human resources management and the internal audit and accounting systems for the WACB. Meanwhile, the organizational structure of two new institutions, the West African Financial Supervisory Authority (WAFSA) and the WAMZ Secretariat has been designed. Institutional frameworks undergoing studies include payments system development, and currency management in the WAMZ. Others are the modalities for introducing the Eco, and foreign exchange management system in the Zone. The various frameworks are presently being fine-tuned.

When the Authority of Heads of State and Government of WAMZ decided in December 2003 to locate the Headquarters of the WACB in Accra, Ghana, it accepted that there was need to sustain the solidarity of the WAMZ countries by ensuring that all participants in the programme have a sense of belonging through a balanced allocation of institutions and management positions. Thus, apart from applying the principle to the WACB Headquarters and appointments to its Executive Board, the Authority directed that a similar approach should be adopted for the proposed WAFSA and WAMZ Secretariat. WAMI has initiated action on these two institutions and proposals were presented to the authorities of WAMZ in the May meetings, in Freetown, Sierra Leone. Among other things, the proposals cover the location of the new institutions, structure and functions, as well as the modalities for funding them. Although the frameworks in place are adequate for launching the Eco, the design process is on-going to ensure a smoother launch of the Eco. It should, however, be noted that the progress made in the area of architecture design can only be useful for launching the monetary union, if commensurate progress is made on macroeconomic convergence.

### **3.0 OUTSTANDING CHALLENGES**

The major challenges facing the authorities on the WAMZ programme can be outlined as follows:

#### **3.1 Expediting the Convergence Process**

The sustenance of macroeconomic convergence is a major prerequisite for economic and monetary integration. In preparation for the introduction of a common currency for the zone, member countries committed themselves to the implementation of policies that would enable them achieve a high degree of economic convergence. However, the present state of affairs regarding the convergence process shows that convergence towards price stability has deteriorated in recent years. In order to ensure a smooth take-off of the monetary union in 2005, countries will need to intensify efforts. This is true, particularly, in the field of public finance, budget deficits and central bank financing of deficits. The current state of affairs regarding public finances in member countries characterized by persistence of large fiscal imbalances seems to suggest that the impact of the Finance Ministers' Forum created in 2003 to address the problem is yet to be felt. A vigorous implementation of the various recommendations of the Forum would go a long way towards reducing fiscal deficits and recourse to central bank financing of such deficits and facilitate achievement of macroeconomic convergence, which would in turn create the enabling environment for the introduction of the common currency, the Eco.

#### **3.2 Implementing the Sensitisation Programme**

The sensitisation of the general public and the various stakeholders on the WAMZ programme is primarily the responsibility of the member countries, with WAMI playing a facilitating role. However, performance of member countries on this programme has been unsatisfactory. There is therefore the need for the countries to provide adequate funding for the sensitisation programme to ensure effective implementation by the National Sensitisation Committees, which would result in the creation of a high level of awareness on the programme. Sufficient budgetary allocations should be made by member countries to the sensitisation programmes, for the message of the common currency project to be taken to all segments of the

society. If the general public and the stakeholders are not sufficiently sensitised, it may be difficult for them to buy into the programme and this could lead to limited success and acceptability. The NSCs should intensify their efforts by addressing the campaign messages to every target group, while WAMI would continue to provide policy direction and technical support in this regard. It is anticipated that member countries will continue to demonstrate their commitment to the programme, and redouble their efforts in the sensitization process. The downside risk for the WAMZ is the failure to sensitize the general public on account of insufficient funding. It is important that the message of the common currency reaches all the stakeholders including the grassroots, especially those in the rural areas, as the coming year is a critical one for the programme to launch the Eco.

### **3.3 Discharging Financial Obligations**

The member countries are required to meet their financial obligations to ensure speedy implementation of the programme. There are four such obligations under the programme. The first is the contribution to the budget of WAMI which has averaged US\$3.0 million annually for 2001 – 2004. The WAMZ Central Banks were directed to meet these obligations on behalf of their countries. These contributions have usually been made promptly and were partly responsible for the effective execution of WAMI's work programme. The record of performance in contributions to the Stabilization and Cooperation Fund (SCF) has not been very satisfactory to the extent that the Fund, aimed at helping member countries to deal with temporary balance of payments problems, has not been operationalised. This is because the minimum contribution of it to start operations had not been paid by member countries. Less than 50 percent of the US\$50 million Fund has been contributed by four of the five member countries. A minimum of 75 percent of the Fund's resources is required for its take-off. The third financial obligation of the programme is the contribution to the capital of the WACB. The authorized capital of the Bank is US\$200 million of which US\$100 million has been called up. Programmed to be paid in four tranches, only three countries have paid the first tranche contribution out of the two that were due by December 2003. The contribution to the capital of the WACB is central to establishing the Bank which is the centrepiece of the monetary union. Substantial resources are needed to provide facilities and personnel for the start of its operations. These payments must therefore be made urgently. If the member countries continue to default on the first two tranches, the outstanding obligations will accumulate in 2004 when the remaining two tranches are due, posing serious risk to the start of operations of the WACB on July 1, 2005, and the launching of the Eco as scheduled.

### **3.4 Ratification of Legal Instruments**

A monetary union involving several countries will necessarily need legal instruments that are to back up agreements among the countries. The legal instruments will need to be ratified by the countries' legislatures. At the initial stage of the WAMZ programme, several legal instruments had to be prepared and endorsed by the Authority to get the programme off the ground. The key legal instruments were the WAMZ Agreement, WAMI's Statute, the Statutes of the SCF and WACB. Only two countries, Guinea and Sierra Leone have got these ratified in Parliament. Since then, the WACB Statute has been significantly revised. Other relevant legislative instruments for the monetary union have reached advanced stages in their preparation. These include instruments on liberalisation of capital movements, banking supervision, harmonisation of legal frameworks for non-bank financial institutions, payments

systems, as well as the agreements on the introduction of Eco banknotes and coins, non-live Eco, collection of statistics and the pact for sustaining the stability of the monetary union from July 2005. WAMI is currently studying the best strategy for the ratification of the various legal instruments. Essentially, the strategy will involve the collaboration of Ministries of Integration and Justice of member countries, the Legislatures, WAMZ Central Banks and WAMI. The tasks before the member countries are to have all the legal instruments endorsed by the Parliaments. In the event that the legal instruments are not ratified, the monetary union cannot commence and Eco can't be launched as scheduled.

### **3.5 Determining Final Eligibility and Sustainability of Monetary Union**

At the end of March 2005, WAMI will conduct a full-scale assessment of the convergence process of the WAMZ from 2000 to 2004 and project to the end of March 2005. The assessment will embrace not only compliance with the quantitative convergence criteria by the WAMZ countries, but also the progress on the qualitative aspects, such as the initiatives on the harmonisation of statistics, payments and banking system reforms. On the quantitative convergence criteria, there will be a thorough analysis of the underlying policy efforts and sustainability of achievements. The challenge is to determine whether the status of the WAMZ programme is indicative of the readiness of the WAMZ countries for the monetary union on July 1, 2005. Thus, a definite pronouncement will be made as to the commencement of the union and the eligible countries for take-off, as well as the likely impact of the monetary union rules and requirements on the countries that have not sufficiently met the minimum conditions for entry. Another challenge on the final assessment on eligibility is to have in place a credible convergence sustainability agreement which will ensure that the monetary union's foundation will continue to be strengthened after the take-off. Such agreement will contain not only specific fiscal rules and continuation of the convergence process, but also penalties for countries in breach of the Agreement.

## **4.0 ARRANGEMENTS TOWARDS INTRODUCING THE Eco**

The arrangements for introducing the WAMZ common currency, Eco, are critical as they reflect the success of the convergence process and actualization of the monetary union in real terms. These activities revolve around piloting the national currencies into the common currency. These activities are summarized as follows:

### **4.1 Exchange Rate Mechanism**

One of the starting points of transition to the introduction of the Eco is the adoption of an Exchange Rate Mechanism (ERM), which ensures that exchange rate fluctuations between currencies of the zone and the US dollar are kept within a band. This would help test the efficacy of monetary and fiscal policies. When monetary and fiscal policies are efficient, the exchange rates would fall within the band, and the stability attained would keep macroeconomic conditions stable in the zone. Furthermore, it would ensure that participating countries reorient their policies towards stability, credibility, foster convergence and prepare them towards adopting the common currency. A stable economic environment is necessary for the good functioning of a single market and for higher investment, growth and employment. The main responsibility of member countries is to make the W-ERM work in line with the operating manual. Thus, the WAMZ Central Banks will rely on their monetary policy

instruments, coordination of monetary and fiscal policies, and foreign exchange market operations, to keep their exchange rates within the fluctuation band.

#### **4.2 A Unit of Account**

The process of introducing the Eco may involve the use of a unit of account as was the case in the European Union. A unit of account serves as a reference for the determination and valuing of transactions. It is an accounting device for placing value on goods and services in an economy. Also, it serves as a store of value and reserve asset. In the WAMZ-ERM the US dollar serves as the anchor for determining the bilateral exchange rates of the various currencies, obviating the need for an explicit unit of account.

#### **4.3 External Value of the Eco**

Reference was earlier made that the external value of the Eco can be determined indirectly with developments in the ERM as a guide. It should be emphasized that this is a critical element of introducing the Eco. The European Union experience is also useful for this exercise. The external value of the Eco can be determined in terms of units per dollar or euro. The irrevocable bilateral conversion rates of the WAMZ currencies into the Eco can be determined through the ERM. When the external value of the Eco has been determined, the bilateral rates can be substituted into the Eco rates. The initial external value of the Eco would be determined taking into account the overall export competitiveness of the Zone. The rate chosen should be optimal and as such should not make any member country lose external competitiveness. Subsequently, the market will determine the external value of the Eco against international currencies, indicating the need for robust macroeconomic policies in the monetary union.

#### **4.4 Phased Introduction of the Eco**

At the inception of the monetary union Eco would be introduced either in physical or accounting form. It is most likely that the Eco would not be introduced in physical form as a result of the long period and technicalities for preparing a currency for issue. A transition period would exist during which Eco would only be used for accounting purposes and bank transactions. During the transitional period before the Eco is introduced live, the national currencies would remain legal tender. Transactions could be undertaken in Eco but it would not be mandatory. The challenge is to design a framework that would ensure that the Eco begins to act as a Zonal currency as the monetary union is launched. In this respect, the non-live Eco to be introduced in the transition period pending when the production of physical Eco could be undertaken would rekindle the confidence of the people on the WAMZ programme. In the transition period, the non-live Eco that would serve as a unit of account and a denominator of transactions in the Zone along with the national currencies, would also sustain the interest of the people of the Zone in the programme before the live Eco is introduced. Without the interim arrangements, doubts may be created as to whether the monetary union has commenced.

#### **4.5 Payments Systems Development**

Payments systems development is an important element of a robust currency management system. As a result, the state of the payments system would determine the extent to which the Eco can be transmitted across the Zone and the buffer stock that would be required to accommodate under estimation of demand for currency. The

payments systems study in progress would provide remedial actions for improving the WAMZ payments systems and preparing them for the launching of the Eco. With an efficient payments system, the pressure on cash during the change over may be minimized making the launch of the Eco less problematic.

#### **4.6 Currency Management**

With the establishment of the monetary union, the WACB would assume the responsibility of implementing the monetary policy frameworks; it shall design, print, supply or distribute to all cash requiring locations appropriately. Similarly, the bank would effect the withdrawal of all mutilated currency and replace it accordingly. The extent to which the Bank can accomplish this task is related to the robustness of the currency management system in place. This problem is being addressed through the current study on currency management in the WAMZ.

#### **5.0 SUMMARY AND CONCLUSION**

This paper has reviewed the challenges posed to the introduction of the Eco. It provided a profile of the performance of the WAMZ programme, reviewing the macroeconomic developments and status of convergence; and the design of the WAMZ architecture. It noted that without convergence and appropriate frameworks for the WAMZ, monetary union would be difficult to launch. While the designing of the architecture of the WAMZ has progressed rapidly, the programme on macroeconomic convergence has been slow, posing challenges to the accomplishment of the monetary union as scheduled. It also outlined other challenges which include the implementation of the sensitisation programme, the prompt discharge of financial obligations, ratification of legal instruments of WAMZ, as well as the fine-tuning of the architecture of the monetary union. In conclusion, the paper examined the arrangements towards the introduction of the Eco.

## SELECTED REFERENCES

- Abudu, M., 2003; “Challenges of the Introduction of the Eco to WAMZ Business and Consumers: A Prognosis”, WAMI, West African Journal of Monetary and Economic Integration, Vol. 3, No. 2, Accra.
- WAMI, 2003; “The Annex to Assessment of the Implementation of the Extended WAMZ Programme During 2003”, Country Reports, Accra, December.
- WAMI, 2002; “Assessment of Preparedness of the West African Monetary Zone for the Monetary Union”, Accra, September.
- WAMI, 2004; “Assessment of the Progress and State of Preparedness for a Single Currency in the WAMZ”; Presentation by WAMI at the Meeting of ECOWAS Central Banks Governors, Dakar, Senegal, June.
- WAMI, 2004; “The Transition into the Monetary Union of the WAMZ, 2004-2005: Critical Steps, Strategies and Responsibilities.
- WAMI, 2002; “Macroeconomic Developments and Convergence Report for 2002”.
- WAMI, 2003; “Macroeconomic Developments and Convergence Report for 2003”.